IS DEED OF TRUST ON PERSONAL PROPERTY AT TIME FIRE INSURANCE POLICY ISSUES VIOLATION OF CONDITION AGAINST INCUMBRANCE BY CHATTEL MORTGAGE?

The fire insurance policy in general use, commonly known as the standard policy, contains the following provision with reference to the incumbrance of personal property:

"This entire policy, unless otherwise provided by agreement endorsed hereon or added hereto, shall be void if * * * or if the subject of insurance be personal property, and be or become incumbered by a chattel mortgage."

The foreign insurance companies doing business in Virginia, and also, as a rule, the domestic insurance companies in this State, use the standard form of policy containing a stipulation against incumbrances expressed as above.

The policy generally issued by the Virginia Fire & Marine Ins. Co. is more comprehensive in this respect, the condition against incumbrances being in the following language:

"This entire policy unless otherwise provided by agreement endorsed hereon or added hereto, shall be void if * * *. Or if the property hereby insured, or any part or item thereof, be or become incumbered by any lien, by mortgage, deed of trust, judgment, or otherwise, either prior or subsequent to the date hereof."

What is the effect, if at the time a fire insurance policy is issued covering personal property, the subject of insurance be incumbered by a deed of trust or chattel mortgage? It does not seem to have been questioned that the form of deed of trust used in Virginia is equivalent to a chattel mortgage, it being, in effect, a mortgage with power of sale. This may be regarded as settled by the Supreme Court of the United States in Hunt *v.* Ins Co., 196 U. S. 47.

This question was squarely presented to our Court of Appeals in the case of Union Assurance Society *v.* Nalls, 101 Va. 613.

There were two questions before the Court in this case. The first turned upon the argument for the insurance company that the existence of a chattel mortgage was a breach of the condition that the interest of the insured in the property should be un-

conditional and sole ownership. The Court readily disposed of this contention, and held that the authorities were practically unanimous to the effect that an incumbrance is not an estate in or title to property, within the meaning of the provision that if the interest of the insured be other than unconditional and sole ownership, the policy shall be void. The second question arose upon the defense by the company that the chattel mortgage existing at the time the policy was issued rendered the policy void under the terms of the express condition against a chattel mortgage, the policy containing in this respect the language of the standard policy as above quoted. There was some evidence that the company knew of the existence of the chattel mortgage, but the court did not rest its decision upon estoppel. The Court decided that the chattel mortgage did not render the policy void, and held unequivocally that notwithstanding the condition against the chattel mortgage, the duty rested upon the insurer to make inquiry as to the existence of such a mortgage, and that in the absence of fraud on the part of the insured the company was not released. This ruling was based upon the prior case of Morotock Ins. Co. *v.* Rodefer, 92 Va. 747. In regard to the last mentioned case, the Court says (101 Va. 616):

"That case holds that where an insurance company elects to issue a policy of insurance against loss by fire without any application, or without any representation in regard to the title to the property to be insured, it cannot complain, after loss has ensued, that the interest of the insured was not correctly stated in the policy, or that an existing encumbrance was not disclosed. In that case, as in this, there was a condition in the policy if the subject of insurance be personal property' the policy shall be void if the property 'be or become mortgaged by a chattel mortgage." Yet, the Court said: 'There is nothing in the policy which required disclosure by the insured of the liens on the property, except the disclosure of any chattel mortgage, where personal property was the subject of insurance; and if the company neglected to make the proper inquiry, it cannot now be permitted, after loss has happened, to defeat a recovery because the insured did not voluntarily disclose the existence of the said mortgage. If an insurance company elects to issue its policy without an application, or any representation in regard to the title to the property upon which the insurance is effected, the company cannot complain, after a loss has ensued, that the interest of the insured was not correctly stated in the policy, or that an existing incumbrance was not disclosed.'"

The Court also refers to West Rockingham Mutual Ins. Co. *v.* Sheets, 26 Gratt. 854; Manhattan Fire Insurance Co. *v.* Weill & Uhlman, 28 Gratt. 389. No reference is made to the prior case of the Sulphur Mines Co. *v.* Phenix Ins. Co., 94 Va. 355, in which a contrary doctrine was advanced. With great respect, it seems to the writer that the ruling in the Nalls case is not supported by the three prior cases to which the learned Court refers, as well as being in conflict with the Sulphur Mines Co. case in 94 Va.

The case in 26 Gratt. was decided in 1875 at a time when it was the common custom of fire as well as life insurance companies to require the intending insurer to answer various interrogatories propounded in a printed form of application which was made the basis of the policy. And out of this custom grew the much discussed doctrine of the difference betw en representation and warranties in the law of insurance. For some years past this custom has been abandoned by the fire insurance companies, and the conditions upon which the policy is to be valid or invalid are inserted in the policy itself. On the face of the policy at issue in the Sheets case there was no stipulation against incumbrances, so that the question presented to the Court turned upon the effect of a representation by the insured, or of his failure to disclose all incumbrances on the one hand, and of the duty of the insurance company to make inquiry as to them on the other hand. The Court held that there was nothing in the policy which required a disclosure by the insured of the liens upon the property; that there was no question propounded by the insurer to the insured in regard to the existence of such liens, and that therefore there had been no false statement made by the insured with reference to incumbrances. The failure of the insured to disclose the existence of a mortgage or lien without being questioned as to it, was not a circumstance material to the risk. It is manifest from the opinion that if, in an application or otherwise, at the time of the issuance of the policy the insurer had asked respecting incumbrances, and an untrue answer had been given, the information would have been material to the risk. This case, therefore, did not involve the effect of violation of a stipulation on the face of the policy itself.

The case in 28 Gratt., as did the case last mentioned, involved

the validity of a policy upon a building. The policy contained a stipulation against the interest of the assured being other than entire unconditional and sole ownership, but contained no condition against the existence of a mortgage. The argument was made before the Court that a deed of trust upon the property was a violation of the condition that it should be void if the interest of the assured in the property were other than the entire unconditional and sole ownership of the property. The Court holds that this condition refers not to the legal title, but to the interest of the assured, and did not constitute a warranty against liens and incumbrances. With reference to the prior case, the court says:

"It was held by this Court in West Rockingham Mutual Fire Ins. Co. *v.* Sheets, 26 Gratt. 871, that unless there be a warranty, or a representation that amounts to a warranty, a policy cannot be avoided for incumbrances, unless upon the applicant's false and fraudulent representation amounting to a warranty, that there are no incumbrances on the property: whether such answer be given in answer to a question or not, if it be untrue, the policy would be void, even though the insured might not be guilty of actual fraud."

In neither of the cases just mentioned was the question ruled upon in the Nalls case before the Court. Yet, the conclusion is irresistible that upon the reasoning of the Court in these two cases, it would follow that the stipulation against a chattel mortgage now contained upon the face of the standard policy would necessarily constitute a warranty upon compliance with which the validity of the policy would depend.

A careful examination of the case of Morotock Ins. Co. *v.* Rodefer, 92 Va. 747, will show, that the question as to the violation of the condition against a chattel mortgage was not passed upon by the Court, although the language used by the Court might seem to apply to that question.

The policy in this Rodefer case was in the standard form. It covered a glass plant consisting of buildings and all machinery, fixtures, stock and certain personal property. There was a mortgage covering real estate and buildings, and also, "all engines, machinery, tools, appliances, connections, attachments, and contrivances of every kind now used in operating the glass factory

on said premises." The Court held that the insurance company had not shown that this description of property in the mortgage embraced personalty; that the engines, etc., might be considered as fixtures, and therefore a part of the realty. It was further held that the existence of the chattel mortgage being a matter of defense, it was incumbent on the company to establish it, and the evidence failed to show that there was a lien on the personal property. It appeared therefore as a fact that the provision against the chattel mortgage had not been violated. The opinion in the case proceeds upon the concessum that the policy would have been void if the Company had established the fact that the policy covered personal property which was incumbered with a chattel mortgage. It is to be observed that in the quotation from the Nalls case made by the Court from this case, which is transcribed above, the Court in the Rodefer case said:

"There is nothing in the policy which required a disclosure by the insured of the liens on the property, *except the disclosure of any chattel mortgage, where personal property was the subject of insurance; etc.*"

So that what the Court says in reference to the failure of the company to inquire as to liens, or of the insured to make any disclosure as to them, had reference only to the mortgage on the building, there being no stipulation on the face of the policy requiring a disclosure by the insured of the liens on the real estate or any part of it. It would seem therefore that the ruling in the Nalls case is not supported by, but is rather in conflict with the decision in the Rodefer case.

In the Nalls case no reference is made to Sulphur Mines Co. *v.* Phenix Ins. Co., 94 Va. 355. In this case the policy contains the following provision:

"This policy is null and void if the property hereby insured, or any part thereof, is mortgaged or otherwise encumbered, either prior or subsequent to date hereof, unless consent to same is endorsed hereon by properly authorized agent of this Company."

At the time the policy issued there was a deed of trust upon all of the property securing the payment of certain bonds. The Court holds:

"In the case before us there is a plain covenant that the policy shall be void if the property was mortgaged at or after the date of the policy, which was a covenant which the parties had a right to make, and which if broken, the courts have no choice but to enforce."

And the Court held the policy to be void. The Court refers to the Sheets case in 26 Gratt., and states:

"The Court is there referring to a policy in which there is no warranty, or representation amounting to a warranty, or condition, or stipulation covering the point under consideration."

The Court also refers to the Rodefer case in 92 Va., with the statement that the company there relied upon the covenant against a chattel mortgage, while it appeared in the proof that there was a mortgage upon the realty but none upon the personalty, and hence the policy was properly construed against the company. The condition of the policy in this case would cover both real estate and personalty, and it does not appear in the statement of the case, or in the opinion, what was the character of the property which was the subject of the insurance. The provision against a chattel mortgage in the standard form of policy is similar in effect to the provision passed upon in the Sulphur Mines Co. case, except that the former relates only to personal property, and the decision in that case would seem upon principle to have settled the question that the violation of the stipulation or covenant against the chattel mortgage would avoid the policy.

The Sulphur Mines Co. case and the Nalls case seem to be irreconcilably in conflict.

The cases of Woody *v.* Old Dominion Ins. Co., 31 Gratt. 362, and Watertown Fire Ins. Co. *v.* Cherry, 84 Va. 72, should be referred to in this connection.

In the case in 31 Gratt. the policy contained a provision that any interest in the property insured "not absolute, or less than a perfect title" should be specially represented to the Company and expressed in the policy in writing, otherwise the insurance should be void. The property had been conveyed to the insured by a deed reserving a vendor's lien for the payment of the purchase money. The Court held that the vendor's lien did not render the interest of the assured not absolute, or less than a perfect

title under a proper construction of that language of the policy. The Court then added: "If this be not the true construction, I am still of opinion that under no proper construction can these words be taken to have been intended to guard against mere incumbrances. If such had been the intention, language more appropriate for the purpose would have been employed, as we find in policies where disclosure of incumbrances is required. In such the requirement is generally plainly expressed. The mere failure, therefore, of the appellant to make known the existence of the lien which appeared on the face of the deed (the policy not requiring such disclosure, and no enquiries being made) did not violate the insurance, there being no fraudulent intent; and no such intent is to be inferred from the evidence. Mut. Fire Ins. Co. *v.* Sheets & Co., 26 Gratt. 854."

In Watertown Fire Ins. Co. *v.* Cherry, *supra,* several of the conditions in the clause of the policy, in which the condition against incumbrance occurs, were violated. As stated in the syllabus, the Court held:

"Policy contained conditions to be void, if the premises became vacant; if the property became incumbered; if the policy be assigned; or if the title of insured be less than fee simple, unless the written consent of the company be endorsed. The conditions were broken. No consent was endorsed. Held: The policy was avoided, whether the breaches were willful and substantial or not."

Lynchburg Fire Ins. Co. *v.* West, 76 Va. 575, may also be referred to, where the Court shows with admirable clearness the difference between a representation and a warranty.

The following principles may be fairly deduced from the cases to which we have thus far referred—with the exception of the Nalls case:

a. If an application for a policy contains an enquiry as to incumbrances, and the incumbrance be not disclosed, and the application be made the basis of the insurance contract, so that the answers become warranties, the untrue answer avoids the policy. This is the general doctrine both in the law of life insurance and fire insurance. Va. F. & M. Ins. Co. *v.* Morgan, 90 Va. 290; Metropolitan Life Ins. Co. *v.* Rutherford, 98 Va. 195; Prudential Fire Ins. Co. *v.* Alley, 104 Va. 365. This has been changed by statute (Code 1904, § 3344a) giving to answers

to interrogatories in an application the effect only of representations. This statute is now in our general Insurance Law—Pollard's Code Biennial, 1908, p. 483.

b. The condition against encumbrances, and the like conditions, when expressed on the face of the policy in the language employed in the standard form, or in language of similar purport, making the validity of the policy dependent upon the consent of the company, is an integral part of the insurance contract in the nature of a warranty or condition precedent; and noncompliance with such conditions avoids the policy contract. The statute just mentioned has no application to conditions of this character contained in the policy itself. Prudential Fire Ins. Co. *v.* Alley, *supra*.

c. Of course, in the application of the condition against incumbrances to concrete cases, the well recognized principle governs that the language is to be construed most strongly against the Company; and the Company may be estopped from relying upon a breach of the condition by knowledge of the actual facts.

In Westchester Fire Ins. Co. *v.* Ocean View Co., 106 Va. 633, the defense of the company was that the building covered by the policy was on ground not owned by the insured, the policy containing a stipulation that in such event it should be void. The argument was made for the insured that the policy had been issued without any application, and without any representation concerning the property made by the assured, and that therefore the company could not rely upon a breach of the condition. In the opinion it is stated that in support of this argument reliance was placed upon the following language taken from the decision in the Nalls case:

"If an insurance company elects to issue its policy without an application or any representation in regard to the title to the property upon which the insurance is issued, the company cannot complain after a loss has ensued that the interest of the insured was not correctly stated in the policy, or that an existing encumbrance was not disclosed;"

this language being quoted in the Nalls case from the prior Rodefer case. The Court reviews the cases above alluded to in 26 Gratt., and in 28 Gratt. and also the Rodefer case, and disapproves the language above quoted. The reason for the conclusion reached by the Court, as shown by its language and the

authorities cited, is that in the case then being consid ed by the Court the parties by express stipulation embodied in the contract itself had made the validity of the contract depend upon compliance with the condition which the defendant company insisted had been violated. The Court held that the insured by accepting the policy is charged with notice of its contents, and bound by its conditions, and that the company by issuing such policy without inquiry, does not waive the conditions as to title and ownership as to the building being on ground not owned by the insured, etc., unless the facts were known to the company, or its agent, when this policy was issued, or the company was chargeable with such knowledge. While overruling the general expressions in the Rodefer and in the Nalls cases, which might seem to sustain a contrary view, the Court, however, said in reference to these two cases, "both of those cases were dealing not with questions of title, but with encumbrances, with respect to which the conclusion reached in those cases was proper." This is true as to the Rodefer case; but the statement was inadvertently made as to the Nalls case; for upon the reasoning employed by the Court in the case in 106 Va. the conclusion reached in the Nalls ase could not be sustained. There is no reason why the stipulation in the policy against incumbrance of personal property by a chattel mortgage should differ in its effect from the stipulation which was being passed upon by the Court in the Ocean View Co. case.

In the still later case of Va. F. & M. Ins. Co. *v.* Case, 107 Va. 588, the question as to the effect of a lien by deed of trust upon personal property was again presented to the Court under conditions differing but little from the circumstances under which the question arose in the case of Sulphur Mines Co. *v.* Phœnix Ins. Co., 94 Va., and in the Nalls case in 101 Va. The language in the policy issued by the Virginia F. & M. Ins. Co. in respect to the matter under consideration has been already noted. In the case just mentioned the subject of the insurance was a threshing machine, part of the purchase price for which was secured by a deed of trust properly recorded. The Court refers to the Ocean View Co. case in 106 Va., and regards that case as having settled the general principle relative to conditions of this character. The Court says:

"In that case the condition of the policy was that it should be void if the interest of the insured was other than unconditional and sole ownership, or if the building insured should be upon ground not owned by the insured in fee simple. In this case the condition of the policy is that it shall be void if the property insured, or any part thereof, was then or should become incumbered by any lien, by mortgage, deed of trust, judgment, or otherwise. If a breach of the condition in the one case avoided the policy, there is no reason why a breach in the other should not do so, and the principle involved in both is the same, and the current of authority is that the policy in the one, as in the other case, stands avoided under the facts disclosed by this record."

In the latest case of Rochester Ins. Co. *v.* M. S. Association, 107 Va. 701, the Court refers to the Ocean View Co. case and to the case just referred to in 107 Va. as settling the general principle that a violation of conditions of the character involved in those cases rendered the policy void.

No reference is made in the last two cases to the Sulphur Mines Co. case in 94 Va., or to the Nalls case.

Considering these three latest cases as bearing upon the question with which this article is headed, the conclusion is inevitable that the Nalls case is to be regarded as overruled, and that the law in this State as to the effect of a chattel mortgage existing upon personal property when it is insured is to be regarded as settled in accordance with the decisions in the Sulphur Mines Co. case in 94 Va., and in Virginia F. & M. Ins. Co. *v.* Case in 107 Va. We conclude therefore that the rule in Virginia is now to be regarded as fixed—that the breach of the stipulation against a chattel mortgage, upon compliance with which the validity of the policy by its terms is made to depend, will avoid the policy and defeat a claim upon it, unless knowledge of the chattel mortgage is brought home to the Company, or it is otherwise estopped from relying upon it.

This principle is in accordance with the decision of the Supreme Court of the United States upon this question, and also with the weight of authority. Hunt *v.* Ins. Co., 196 U. S. 47; Vance Ins., pp. 447-8; Ostrander on Fire Ins., p. 253; 2 Cooley Briefs on the Law of Ins., pp. 1396-7-8; and 13 Virginia Law Reg. 718.

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